



MEMO

TO: Members of the House Insurance Committee

FROM: Kurt Gallinger, Chair, Michigan Insurance Coalition

DATE: Tuesday, October 11, 2011

RE: Health Providers' Testimony

You just heard testimony from the health provider community concerning their inability to survive in the current economic circumstances and that shifting costs from the shortcomings of government programs to Michigan drivers has to be permitted to continue if they are to survive financially. You might ask then, how **Spectrum Health System can report a \$1.4 billion fund balance** as of the end of their most recent fiscal year – March 31, 2011 (see page 10 of their financial statement which is attached).

While we applaud Spectrum for their financial success, we think the idea of this legislation being an imminent threat to their financial sustainability needs to be removed from the dialogue.

SPECTRUM HEALTH SYSTEM AND AFFILIATES

CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2011

SPECTRUM HEALTH



SPECTRUM HEALTH SYSTEM & AFFILIATES

CHIEF FINANCIAL OFFICER'S REPORT

FOR THE NINE MONTHS ENDED MARCH 31, 2011

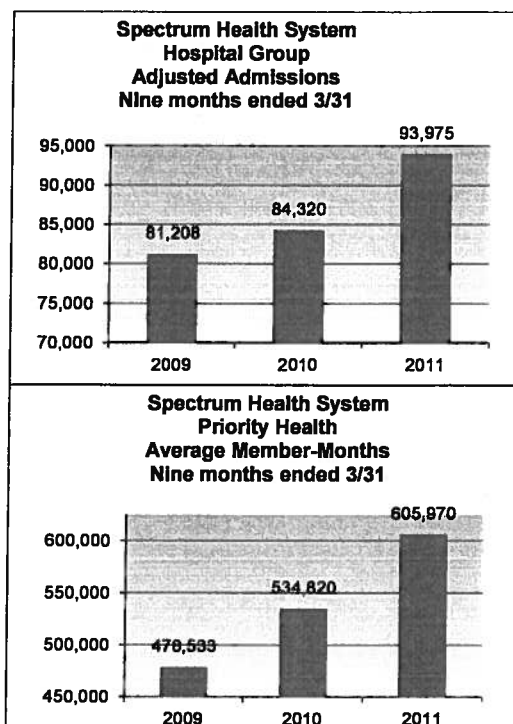
The enclosed package represents the consolidated financial statements for Spectrum Health System and its Affiliates (the System). The financial statements have been summarized by the System's delivery, insurance and other operations.

Zeeland Community Hospital became a wholly-owned subsidiary of the System effective January 1, 2011. Operating results for ZCH are included in the System's results from the effective date of the transaction.

There were three organizational changes that occurred in fiscal 2010. MMPC became a wholly-owned subsidiary of the System effective August 6, 2009. West Michigan Heart became a wholly-owned subsidiary of the System effective December 31, 2009. Gerber Memorial Hospital became a wholly-owned subsidiary of the System effective May 1, 2010. Operating results of these entities are included in the System's results from the effective date of the transaction.

Volume

The Hospital Group adjusted (for outpatient) admissions increased 11.5% compared to March 31, 2010 levels, and totaled 93,975 (increased 0.9% excluding impact of new entities). Inpatient admissions increased 6.9% compared to March 31, 2010, and totaled 47,161 for the year (increased 1.5% excluding impact of new entities). Physician Services encounters totaled 1,090,478 which were 4.9% below budget. Health insurance membership (in member-months) increased by 13.3% compared to March 31, 2010.

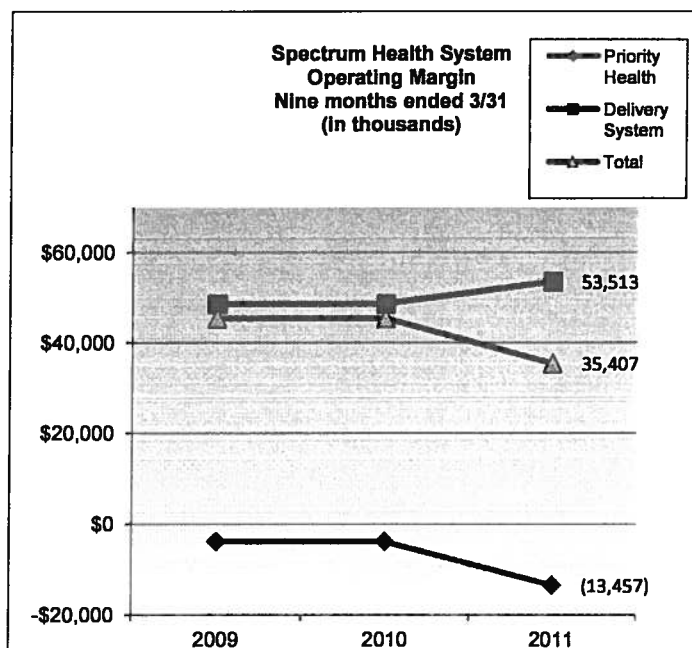


Margin

The System's excess of revenue over expense for the nine months ended March 31, 2011, was \$197.6 million or 6.9% of total revenue. The System's operating income was \$35.4 million or 1.3% of net operating revenue. The operating margin was \$9.3 million below the planned operating margin of \$44.7 million.

The Delivery System operating margin was \$53.5 million, which was better than budget by \$5.5 million, and better than the prior year by \$5.0 million. The Delivery System primarily consists of the Hospital Group and Physician Services.

The Priority Health operating loss was \$13.5 million, which was worse than budget by \$16.7 million, and worse than the prior year by \$9.6 million. These losses were driven by the commercial losses in the small group sector in the first six months of the fiscal year. Priority Health implemented several initiatives to improve operating results. These initiatives included pricing increases, small group reforms, including the reduction of the product offerings, and MCAP savings initiatives. These programs have resulted in favorable operating margins of \$9.7 million for the three months ended March 31, 2011.



SPECTRUM HEALTH SYSTEM & AFFILIATES

CHIEF FINANCIAL OFFICER'S REPORT

FOR THE NINE MONTHS ENDED MARCH 31, 2011

The net non-operating gain of \$161.6 million was comprised of \$119.1 million of gains on investments, \$18.0 million of gains on financial instruments and the accounting contribution of Zeeland Community Hospital of \$28.4 million, offset by \$3.9 million of other expense. The \$161.6 million gain was \$139.5 million better than the target of \$22.1 million, and \$22.4 million better than the prior year.

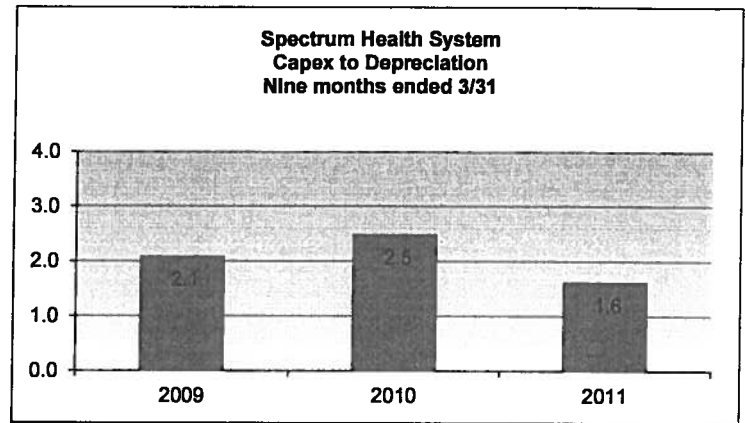
Liquidity and Cash Flow

At March 31, 2011, total cash and short-term investments for the System were \$354.5 million, an increase of \$61.1 million from \$293.4 million at June 30, 2010. Cash inflows consist primarily of cash provided by operating activities of \$228.7 million, proceeds from the issuance of long-term debt of \$56.5 million, and cash from Zeeland Community Hospital of \$16.3 million. Cash inflows were offset by net capital expenditures of \$153.1 million and payments on long-term debt of \$100.4 million.

Ratios

Days cash on hand for the System declined from 140.1 at June 30, 2010 to 130.8 at March 31, 2011. The Delivery System remained constant at 163.0 days. Priority Health declined from 86.5 to 82.8. The collateral posting decreased \$22.4 million since June 30, 2010.

Priority Health's risk based capital (RBC) declined from 327.6% at June 30, 2010 to 283.0% at March 31, 2011.



Equity Structure

Long-term debt, current portion of LT debt and LT debt subject to remarketing, was approximately \$873.6 million at the end of March, while fund balance was approximately \$1.4 billion. The long-term debt to capitalization ratio for the System was 39.6%, which was higher than the Moody's Aa3 median of 33.9% for 2009. Total assets for the System were approximately \$3.1 billion.

Respectfully submitted,

Michael P. Freed
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(mike.freed@spectrum-health.org)
March-11

SPECTRUM HEALTH SYSTEM & AFFILIATES

Ratio Analysis - Total System

March 31, 2011

	Total System 3/31/11	Total System 6/30/10	2009 Moody's Median
<u>Profitability Ratios</u>			
Operating Margin	1.3%	1.3%	3.4%
Total Margin (excluding unrealized gain/loss on invest)	3.6%	1.3%	6.6%
Total Margin (including unrealized gain/loss on invest)	6.9%	3.7%	6.6%
Return on Assets	8.6%	4.2%	5.5%
Operating Cash Flow Margin	5.4%	5.7%	10.0%
<u>Liquidity Indicators</u>			
Days in Receivables	22.5	20.5	46.6
Days Cash (unrestricted) on Hand	130.8	140.1	201.5
Current Ratio	0.9	1.0	1.7
Cash to Debt %	142.7%	132.3%	154.8%
<u>Capital Structure</u>			
Long Term Debt to Capitalization	39.6%	44.2%	33.9%
Debt Service Coverage	12.7	6.3	6.1
Debt to Cash Flow	2.2	3.7	2.9
Risk Based Capital (PH only)	283.0%	327.6%	793.3% (a)
Average Age of Plant	7.6	7.5	9.0

(a) AM Best benchmark

Note: Moody's figures are medians for hospitals with Aa3 bond ratings for 2009, excluding multi-state hospital systems. Spectrum Health's current rating from Moody's is Aa3.

SPECTRUM HEALTH SYSTEM & AFFILIATES**Key Statistics**

Nine months ended March 31, 2011

	Actual	Better (Worse) than Budget	Prior Year
<u>Hospital Group Statistics</u>			
Admissions	47,161	18	44,114
Patient Days - Acute care	206,002	(142)	196,635
Patient Days - Observation	11,466	712	10,447
Patient Days - Long-term care	161,495	(2,404)	159,858
Adjusted Admissions	93,975	734	84,320
Cost per Adj. Patient Admission	12,067	71	12,365
<u>Spectrum Health Hospitals</u>			
Admissions	42,146	359	41,281
Patient Days - Acute care	190,522	872	187,625
Patient Days - Observation	10,438	411	9,917
Adjusted Admissions	71,618	1,245	69,968
Cost per Adj. Patient Admission	13,827	220	13,851
<u>Spectrum Health Reed City</u>			
Admissions	547	(164)	677
Patient Days - Acute care	1,711	(580)	2,148
Patient Days - Observation	45	(3)	48
Patient Days - Long-term care	13,556	(596)	14,172
Adjusted Admissions	4,567	(432)	5,395
Cost per Adj. Patient Admission	6,157	(297)	5,084
<u>Spectrum Health Continuing Care</u>			
Patient Days - combined	129,826	(1,915)	127,818
VNA Admissions (Home Health)	4,310	277	3,674
Hospice Days	52,577	6,541	39,114
<u>Spectrum Health United</u>			
Admissions	1,943	(69)	1,926
Patient Days - Acute care	6,210	52	6,055
Patient Days - Observation	441	(73)	411
Patient Days - Long-term care	10,460	278	10,059
Adjusted Admissions	6,739	(351)	6,818
Cost per Adj. Patient Admission	5,748	(154)	5,522

SPECTRUM HEALTH SYSTEM & AFFILIATES

Key Statistics

Nine months ended March 31, 2011

	Actual	Better (Worse) than Budget	Prior Year
<u>Spectrum Health Kelsey</u>			
Admissions	156	(32)	230
Patient Days - Acute care	422	(445)	807
Patient Days - Observation	88	17	71
Patient Days - Long-Term Care	7,653	(171)	7,809
Adjusted Admissions	2,175	27	2,139
Cost per Adj. Patient Admission	3,978	23	3,939
<u>Spectrum Health Gerber</u>			
Admissions	1,865	(76)	n/a
Patient Days - Acute care	5,328	(41)	n/a
Adjusted Admissions	7,500	245	n/a
Cost per Adj. Patient Admission	6,878	(128)	n/a
<u>Spectrum Health Zeeland</u>			
Admissions	504	n/a	n/a
Patient Days - Acute care	1,809	n/a	n/a
Patient Days - Observation	94	n/a	n/a
Adjusted Admissions	1,376	n/a	n/a
Cost per Adj. Patient Admission	7,078	n/a	n/a
<u>Spectrum Health Physician Services</u>			
Encounters	1,090,478	(56,177)	n/a
<u>Priority Health & Sub / PHMB</u>			
Number of Member Months			
- Commercial (PH & Sub)	3,414,238	56,674	3,249,829
- PPO (PH & Subs)	614,719	(52,885)	457,069
- Self-funded (PHMB)	412,811	(12,710)	316,187
Total Commercial	4,441,768	(8,921)	4,023,085
- Medicaid (PH & Sub)	569,607	(17,160)	560,224
- Medicare (PH & Subs)	442,356	(23,819)	230,074
Total Governmental Programs	1,011,963	(40,979)	790,298
Total Member Months	5,453,731	(49,900)	4,813,383
Medicare Rx	22,796	(3,103)	25,960
Medigap	7,674	(7,271)	n/a

SPECTRUM HEALTH SYSTEM - CREDIT GROUP*

Liquidity Report

Summary as of March 31, 2011

(in thousands)

ASSETS

Daily Liquidity (1)

Money Market Funds	\$	72,300	
Repurchase Agreements		36,847	
Availability on Syndicate Line of Credit		85,500	
Subtotal Daily Liquidity			\$ 194,647

Weekly Liquidity (1)

Fixed Income - Active and Passive		307,285	
Equity - Active and Passive		332,847	
Subtotal Weekly Liquidity			640,132

TOTAL DAILY AND WEEKLY LIQUIDITY

834,779

Longer Term Liquidity (1)

Funds, vehicles, investments that allow withdrawals with less than one month notice

-

Funds, vehicles, investments that allow withdrawals with one month notice or longer

-

TOTAL LONGER TERM LIQUIDITY

-

TOTAL LIQUIDITY

\$ 834,779

LIABILITIES - Debt Due Within 1 Year

Long-Term Debt Subject to Remarketing (2)

2008B1 VRDB's - RBS/Citizens Letter of Credit expires 7/29/2011	\$	71,500	
2005B Serial Mode Bonds - put date 7/15/11		90,000	
2008A1 Serial Mode Bonds - put date 1/15/12		74,900	
			\$ 236,400

Current Maturities of Long-Term Debt (3)

1998A Bonds - January 15, 2011		2,555	
Other		2,679	
			5,234

TOTAL DEBT DUE WITHIN 1 YEAR

\$ 241,634

(1) Excludes ERISA and restricted funds

(2) Included in current liabilities on the consolidated balance sheets

(3) Included in current maturities of long term debt on the consolidated balance sheets

*The Credit Group consists of Spectrum Health System, Spectrum Health Hospitals, Spectrum Health United, and Spectrum Health Continuing Care including its wholly owned subsidiaries and excluding Spectrum Health Kent Community Campus.

SPECTRUM HEALTH SYSTEM & AFFILIATES

BALANCE SHEETS

March 31, 2011

(in thousands)

	Delivery System	Priority Health	Eliminations & Other	Total
Cash and short-term investments	\$40,455	\$307,457	\$6,598	\$354,510
Accounts receivable, net	175,779	40,369		216,148
Third party receivables	8,032			8,032
Pledges receivable	1,449		7,608	9,057
Prepaid expenses and other current assets	62,212	23,211	7,526	92,949
Total Current Assets	287,927	371,037	21,732	680,696
Due from affiliates	20,558		(20,558)	0
Investment in system				0
Assets limited as to use & other LT investments	744,359	175,082	(27,313)	892,128
Bond and Restricted Funds			20,908	20,908
Donor and Restricted Assets				
Investments	2,468		59,476	61,944
Assets designated for affiliates (FAS 136)	77,418		(77,130)	288
Pledges receivable	25,106		17,869	42,975
	104,992		215	105,207
Property and equipment, net	1,219,365	46,479	12,839	1,278,683
Other assets:				
Investment in Joint Ventures	6,628		10	6,638
Goodwill, net	2,061	10,331	7,871	20,263
Other intangible assets and costs	10,028	13,873	(1,513)	22,388
Other long-term assets	94,280	5,705	(52,193)	47,792
	112,997	29,909	(45,825)	97,081
TOTAL ASSETS	\$2,490,198	\$622,507	(\$38,002)	\$3,074,703
Accounts payable and accrued expenses	\$213,293	\$81,991	(\$3,717)	\$291,567
Health plan claims payable (HMO only)		204,110		204,110
Long-term debt subject to remarketing	236,400			236,400
Current maturities of Long Term Debt	10,208	899		11,107
Total Current Liabilities	459,901	287,000	(3,717)	743,184
Due to affiliates	17,149	23,207	(40,356)	0
Third party settlement liabilities	39,467			39,467
Swap Market Value	3,714		56,100	59,814
Long-term debt, less current portion	576,758	39,374	10,000	626,132
Professional liability accrual			33,301	33,301
Other long term liabilities	163,744	34,689	(83,085)	115,348
Net Assets (deficit):				
Common Stock	1,640	19	(1,659)	0
Additional paid-in capital	23,723	53,993	(77,716)	0
Unrestricted (deficit)	1,094,056	184,225	55,507	1,333,788
Temporarily restricted	73,877		(467)	73,410
Permanently restricted	36,068		41	36,109
Total System Net Assets	1,229,364	238,237	(24,294)	1,443,307
Non-controlling interest	101		14,049	14,150
Total Net Assets	1,229,465	238,237	(10,245)	1,457,457
TOTAL LIABILITIES AND NET ASSETS	\$2,490,198	\$622,507	(\$38,002)	\$3,074,703

SPECTRUM HEALTH SYSTEM & AFFILIATES**COMBINED STATEMENTS OF ACTIVITIES****Nine months ended March 31, 2011**

(in thousands)

OPERATING REVENUE (net of deductions)

	Delivery System	Priority Health	Eliminations & Other	Total
Health plan		\$1,572,000	(\$78,199)	\$1,493,801
Hospital, continuing care and physician services	\$1,411,399		(270,578)	1,140,821
Investment income		8,182	443	8,625
Other	42,088	12,202	(1,427)	52,863
Total operating revenue	1,453,487	1,592,384	(349,761)	2,696,110

OPERATING EXPENSES

Salaries, wages and employee benefits	760,140	60,937	(45,341)	775,736
Supplies and other	485,439	76,669	(33,902)	528,206
Health Plan payments to other providers (HMO only)		1,457,813	(270,578)	1,187,235
Bad Debt Expense	58,109	161		58,270
Depreciation and amortization	80,725	8,568	6,021	95,314
Interest	15,561	1,693	(1,312)	15,942
Total operating expenses	1,399,974	1,605,841	(345,112)	2,660,703
Excess of operating revenue over (under)				
operating expenses	53,513	(13,457)	(4,649)	35,407

OTHER REVENUE (EXPENSE):

Investment income	38,964	518	774	40,256
Unrealized gain (loss) on investments	24	5,398	73,458	78,880
Realized & unrealized gain(loss) on financial instrument	(1,498)		19,483	17,985
Other income (expense)	(1,449)	(635)	(1,810)	(3,894)
Contribution received in donation of ZCH	27,723		642	28,365
Loss on extinguishment of debt				0
Total other revenue (expenses)	63,764	5,281	92,547	161,592
EXCESS OF REVENUE OVER (UNDER) EXPENSES	117,277	(8,176)	87,898	196,999
Less: Excess of revenue over (under) expenses				
attributable to noncontrolling interest	(17)		(609)	(626)
EXCESS OF REVENUE OVER (UNDER) EXPENSES				
ATTRIBUTABLE TO SYSTEM	\$117,294	(\$8,176)	\$88,507	\$197,625

SPECTRUM HEALTH SYSTEM & AFFILIATES

STATEMENT OF ACTIVITIES (continued)

March 31, 2011

(in thousands)

	Delivery System	Priority Health	Eliminations & Other	System Total	Non- Controlling Interest	Total
Net asset balance (deficit) at beginning of year	\$1,031,651	\$192,401	\$4,508	\$1,228,560	\$14,776	\$1,243,336
Excess of revenue over (under) expenses	117,294	(8,176)	88,507	197,625	(626)	196,999
Contributions	543		16,784	17,327		17,327
Contribution received in donation of ZCH						0
Net assets released from restriction:	83			83		83
Expenditures of donor sponsored programs			(6,045)	(6,045)		(6,045)
Investment Income from Restricted Net Assets			1,446	1,446		1,446
Net unrealized gains (losses) on Investments held	64,875		(64,875)			0
FAS 136 activity - current year	1,633		(1,633)			0
Minimum pension liability						0
Transfers: Parent	(30,114)		30,114			0
Hospitals	12,835		(12,835)			0
Foundation						0
Hospital Group affiliates	890		(890)			0
BAC						0
Other	4,311			4,311		4,311
Net asset balance (deficit) at end of year	\$1,204,001	\$184,225	\$55,081	\$1,443,307	\$14,150	\$1,457,457

Spectrum Health System & Affiliates
Statement of Cash Flows Support
Nine Months Ended March 31, 2011

(in thousands)

	Delivery System	Priority Health	Eliminations & Other	Total
<u>OPERATING ACTIVITIES AND OTHER REVENUE</u>				
Change in net assets	\$175,885	(\$8,176)	\$46,410	\$214,119
Contributions and other net asset activity	(4,937)		(12,185)	(17,122)
Contributions received in donation of ZCH	(27,723)		(642)	(28,365)
Unrealized (gain) loss in market value of financial instruments	(998)		(19,483)	(20,481)
Depreciation and amortization	80,725	8,568	6,021	95,314
Changes in operating assets and liabilities:				
Trading securities				
- Assets limited as to use	(117,956)	20,180	93,068	(4,708)
- Bond and Restricted Funds			22,377	22,377
- Donor restricted investments	(857)		(11,279)	(12,136)
Unrealized gains (losses) on investments	64,875		(64,875)	0
FAS136 changes	(1,633)		1,633	0
Decrease (increase) in net a/r, inventories, prepaid expenses, third-party settlement receivables and other operating assets	(21,907)	(24,558)	2,885	(43,580)
Increase (decrease) in a/p, accrued expenses, accrued salaries and related withholdings, health plan claims payable, third-party settlement liabilities and other operating liabilities	(26,605)	72,405	(21,159)	24,641
Other	(1,420)		15	(1,405)
Net cash provided by (used in) operating activities and other revenue	117,449	68,419	42,786	228,654
<u>INVESTING ACTIVITIES</u>				
Additions to property and equipment, net	(153,927)	(8,188)	9,030	(153,085)
Investment in System				0
Addition of Zeeland Community Hospital cash	16,277			16,277
Other	5,424		(9,472)	(4,048)
Net cash provided by (used in) investing activities	(132,226)	(8,188)	(442)	(140,856)
<u>FINANCING ACTIVITIES</u>				
Contributions and other net asset activity	4,931		12,184	17,115
Proceeds from issuance of long-term debt	25,500		31,000	56,500
Payment of long-term debt	(42,576)	(774)	(57,000)	(100,350)
Inter-company - due to/due from affiliates, net	37,596	17,952	(55,548)	0
Inter-company transfers	(16,389)		16,389	0
Net cash provided by (used in) financing activities	9,062	17,178	(52,975)	(26,735)
Increase (decrease) in cash	(5,715)	77,409	(10,631)	61,063
Cash and short-term investments, beginning of year	46,170	230,048	17,229	293,447
Cash and short-term investments, end of year	\$40,455	\$307,457	\$6,598	\$354,510